(4)

Supreme Court, U.S.
FILED
OCT 25 2006
OFFICE OF THE CLERK

No. 06-465

IN THE
Supreme Court of the United States

SHARON PRICE AND MICHAEL FRUTH, INDIVIDUALLY AND ON BEHALF OF ALL OTHERS SIMILARLY SITUATED,
Petitioners,

v.

PHILIP MORRIS INCORPORATED, *ET AL.*,
Respondents.

On Petition for a Writ of Certiorari to the Supreme Court of Illinois

REPLY BRIEF FOR PETITIONERS

STEPHEN M. TILLERY
701 Market Street
Suite 300
St. Louis, Missouri 63101
(314) 241-4844

DAVID C. FREDERICK
Counsel of Record
MARK L. EVANS
KELLY P. DUNBAR
KELLOGG, HUBER, HANSEN, TODD, EVANS & FIGEL, P.L.L.C.
1615 M Street, N.W.
Suite 400
Washington, D.C. 20036
(202) 326-7900

Counsel for Petitioners

October 25, 2006

AMENDED LIST OF PARTIES TO THE PROCEEDINGS

Petitioners inadvertently omitted from the caption of their petition the following law schools that, by order dated September 1, 2004, were granted leave by the Illinois Supreme Court to file a brief as appellees in the proceedings below and therefore are respondents in this Court:

Washington University (St. Louis) School of Law
St. Louis University School of Law
University of Illinois College of Law
Southern Illinois University School of Law
Northern Illinois University College of Law
Northwestern University School of Law
University of Chicago Law School
The John Marshall School of Law
Chicago-Kent College of Law (I.I.T.)
DePaul University College of Law
Loyola University Chicago School of Law

TABLE OF CONTENTS

Page

AMENDED LIST OF PARTIES TO THE PROCEEDINGS i

TABLE OF AUTHORITIES iii

ARGUMENT:

I. PHILIP MORRIS'S PROCEDURAL OBJECTIONS HAVE NO MERIT 1

A. This Court Has Jurisdiction To Review The Federal-Law Issue Presented By The Petition 1

B. The Federal-Law Issue Is Before This Court 4

II. THIS PETITION RAISES IMPORTANT ISSUES WARRANTING THIS COURT'S REVIEW 5

A. The Court Below Erred In Interpreting The Purpose And Effect Of FTC Consent Orders 6

B. The Divide Over The Legal Effect Of FTC Consent Orders Is Significant 8

III. THE COURT SHOULD ALSO CONSIDER HOLDING THIS CASE FOR *WATSON* OR CALLING FOR THE GOVERNMENT'S VIEWS 10

CONCLUSION 10

TABLE OF AUTHORITIES

Page

CASES

Beatrice Foods Co. v. FTC, 540 F.2d 303 (7th Cir. 1976) 9

FTC v. Mandel Bros., Inc., 359 U.S. 385 (1959) 5, 6

General Motors Corp. v. Abrams, 897 F.2d 34 (2d Cir. 1990) 6

Grable & Sons Metal Prods., Inc. v. Darue Eng'g & Mfg., 125 S. Ct. 2363 (2005) 4

Holloway v. Bristol-Myers Corp., 485 F.2d 986 (D.C. Cir. 1973) 6

Intergraph Corp. v. Intel Corp., 253 F.3d 695 (Fed. Cir. 2001) 9

Lebron v. National R.R. Passenger Corp., 513 U.S. 374 (1995) 5

Merrell Dow Pharms. Inc. v. Thompson, 478 U.S. 804 (1986) 4

Michigan v. Long, 463 U.S. 1032 (1983) 3, 4

Ohio v. Reiner, 532 U.S. 17 (2001) 4

Sakon v. Pepsico, Inc., 553 So. 2d 163 (Fla. 1989) 9

San Francisco Police Officers' Ass'n v. City & County of San Francisco, 812 F.2d 1125 (1987), *withdrawn and superseded*, 869 F.2d 1182 (9th Cir. 1988) 6

Schubach v. Household Fin. Corp., 376 N.E.2d 140 (Mass. 1978) 6

Standard Oil Co. v. Johnson, 316 U.S. 481 (1942) 1, 2, 3, 4

State v. O'Neill Investigations, Inc., 609 P.2d 520 (Alaska 1980) 6

Trans Union Corp. v. FTC, 245 F.3d 809, *on denial of reh'g*, 267 F.3d 1138 (D.C. Cir. 2001) 8, 9

United States v. E.I. du Pont de Nemours & Co., 366 U.S. 316 (1961) 6, 7, 8

United States v. Williams, 504 U.S. 36 (1992).....5

Watson v. Philip Morris Cos., 420 F.3d 852 (8th Cir. 2005), *petition for cert. pending*, No. 05-1284 (filed Apr. 7, 2006).....10

Whitinsville Plaza, Inc. v. Kotseas, 390 N.E.2d 243 (Mass. 1979).....9

ADMINISTRATIVE DECISIONS

In re Trans Union Corp., Docket No. 9255, 2000 FTC LEXIS 23 (F.T.C. Feb. 10, 2000) 8, 9

STATUTES

Federal Trade Commission Act, 15 U.S.C. §§ 41 *et seq.*:

15 U.S.C. § 45(m)(1)(B) 7

Philip Morris does not deny that the question presented here — whether, as a matter of federal law, a negotiated Federal Trade Commission ("FTC") consent order immunizes non-parties from liability under otherwise applicable state law for conduct similar to that addressed in the consent order — is both important and recurring. Nor does Philip Morris seriously defend the Illinois Supreme Court's erroneous view of the legal effect of such consent orders. Instead, it offers meritless jurisdictional objections and mischaracterizes the cases underlying the deep conflict on the legal effect of FTC consent orders. This Court should grant review to resolve the existing split among the state courts and federal courts of appeals and to ensure that FTC consent orders are not given unintended effect in a manner that damages the FTC's enforcement objectives.

I. PHILIP MORRIS'S PROCEDURAL OBJECTIONS HAVE NO MERIT

A. This Court Has Jurisdiction To Review The Federal-Law Issue Presented By The Petition

Although the ultimate issue before the Illinois Supreme Court was whether Philip Morris was liable under state law for its fraudulent conduct, the court recognized that, because of a statutory exemption for conduct authorized by a federal regulatory body, it could resolve that issue only by first deciding a "dispositive" (Pet. App. 64a) threshold issue of federal law — whether two FTC consent orders were "an implicit authorization for other industry members to conduct themselves in the same manner." *Id.* at 70a. As the Illinois court put it, "the real issue is whether the FTC has specifically authorized [Philip Morris] and other cigarette manufacturers to use [light descriptors] on their packaging and in their advertising." *Id.* at 56a. This Court settled long ago that, when resolution of a state-law issue depends on a determination of federal law, this Court has jurisdiction to review the federal-law question. *See Standard Oil*, 316 U.S. at 483-85.

Philip Morris maintains that the Illinois court did not decide an issue of federal law and that, "no matter how this Court interprets federal law, the Illinois Supreme Court's decision would remain the same." Opp. 14. But, in numerous passages, the Illinois Supreme Court was emphatically clear that, to decide whether Philip Morris could invoke the state statutory safe-harbor exemption, the court had to analyze and construe the legal effect of FTC consent orders on non-parties. *See* Pet. 29-30.[1]

That question — the legal effect of FTC consent orders on non-parties — is a "relationship which is controlled by federal law." *Standard Oil*, 316 U.S. at 483. And the Illinois court's analysis assumed as much. The court based its holding on "authorization" directly on what it perceived as an FTC judgment not to take enforcement action against Philip Morris's frauds: "Because [Philip Morris] was specifically authorized to use [light descriptors] *without fear of the FTC challenging them as deceptive or unfair*, it is exempt from civil liability" under state law. Pet. App. 86a (emphasis added). But Illinois law cannot create such a safe harbor from *federal* enforcement efforts; only federal law can do so. Thus, the court necessarily con-

---

[1] *See* Pet. App. 67a (court must "delve deeply into the functions and actions of a federal agency"); *id.* at 70a (reading FTC statements as "suggest[ing] that a consent order may serve as authorization for non-parties to the order to follow its directives"); *id.* at 77a (construing federal authority to mean that "consent orders obtained by the FTC with respect to one industry member" authorize "other industry members to act in conformity with those orders"); *id.* at 79a (the FTC "could, and did, specifically authorize all United States tobacco companies" to use light descriptors); *id.* at 86a ("[A] consent order entered into by the FTC with one member of a regulated industry . . . provides implied authority for other members of the regulated industry to engage in the same conduct."); *see also id.* at 161a ("Illinois courts necessarily have become embroiled in the technical aspects of FTC voluntary consent orders") (Freeman, J., dissenting upon denial of rehearing); *id.* at 166a (FTC consent orders were "at the heart of [the court's] analysis").

strued *federal* law in deciding that Philip Morris was exempt from liability under the state safe harbor provision.[2]

Philip Morris relies heavily (Opp. 13-14) on the Illinois court's statement that it "resolved the . . . case entirely on the basis of state law by construing and applying an exemption clause in a state statute." Pet. App. 87a. Certainly the court had to decide whether the state statutory exemption immunized Philip Morris from all liability for its many fraudulent actions. *See* Pet. 29-30. But, in resolving that question, the court had to determine the legal effect of the FTC's actions — quintessentially a matter of federal law. In our federal system, a state court cannot flout this Court's precedents and a federal agency's own interpretations of its acts to decide that a federal agency has "authorized" certain conduct. Particularly given the Illinois court's apparent effort to ascertain how the FTC treats its own consent orders and the legal effect those orders are given under federal judicial decisions, the court's statements that it was resolving the case based entirely on state law are more plausibly read as simply misunderstanding the interplay between federal and state law when a federal agency's action is given legal effect in a state statute.[3]

Michigan v. Long, 463 U.S. 1032 (1983), does not affect that analysis. The clear-statement rule of *Long* applies when it is unclear whether a state court's judgment rests on a federal-law ground or on an independent and adequate state-law ground. *See id.* at 1040-42. That is not

---

[2] Dr. Peterman testified (Opp. 6-7), albeit erroneously, about the significance of FTC consent orders as a matter of *federal* law. That testimony cannot overcome the authority demonstrating that FTC consent orders may not be used to regulate non-parties. *See* Pet. 15-22.

[3] Philip Morris's arguments here confirm the point. It defends the court's decision by arguing that "consent decrees . . . can be used to set policy for industries as a whole — not just the participants involved in the proceeding." Opp. 20. In our federal system, a state court simply has no power to make such a determination. Whether FTC consent orders do have such an industry-wide effect rests on federal law.

the issue here. State law unquestionably provides the basis for Philip Morris's liability and defines the scope of the exceptions to that liability. But the federal-law issue is embedded within the ultimate question of state-law liability. *Long* neither speaks to nor addresses a situation where, as here and in *Standard Oil*, state law *incorporates* an issue of federal law. In those cases, this Court clearly "'retains power to review the decision of a federal issue in a state cause of action.'" *Ohio v. Reiner*, 532 U.S. 17, 20 (2001) (per curiam) (quoting *Merrell Dow*, 478 U.S. at 816); *Standard Oil*, 316 U.S. at 483. *See also Grable*, 125 S. Ct. at 2368 (federal jurisdiction where IRS notice was "essential element of [state] claim"). The state court is free to construe broadly the scope of the exceptions; but, in applying those exceptions to a federal agency's actions, the court must correctly construe federal law.[4]

Given the substantial federal interests in a uniform interpretation of the FTC's consent-decree practices and effects, this Court must have jurisdiction to correct erroneous interpretations of FTC actions. *See* Pet. 24-27. To accept Philip Morris's rationalization of the lower court's action would lead to the unacceptable result that the 33 other States with similar safe-harbor provisions (Pet. App. 234a) could adopt idiosyncratic understandings of federal regulatory practice and insulate them from this Court's review. FTC enforcement efforts would be chilled greatly under such a patch-work regime. *See* Pet. 27.

B. The Federal-Law Issue Is Before This Court

Philip Morris's waiver argument (Opp. 25-26) also has no merit. Before the Illinois court, Philip Morris argued that the 1971 and 1995 consent orders regulated non-

---

[4] Philip Morris quotes statements that the court intended "'to ascertain and give effect to the intent of the legislature.'" Opp. 13 (quoting Pet. App. 56a-57a). In so stating, the court was construing the *scope* of the exceptions and not the *application* of them to a federal agency's practices. *See, e.g.*, Pet. App. 50a ("Once the statute is properly construed, its terms must be applied to the circumstances of the individual case to determine whether it bars this action.").

parties and that those federal decrees *preempted* state causes of action. *See* Appellant's Opening Br. 53, 58-60 (Ill. filed Dec. 10, 2003). Petitioners answered by arguing, among other things, that those consent orders were entered "against other cigarette companies" and did not authorize "Philip Morris' use" of light descriptors. Appellees' Br. 65 (Ill. filed July 12, 2004). Petitioners cited, for example, the FTC's 1997 notice as proof that the FTC had not authorized, through consent orders or otherwise, the use of light descriptors on an industry-wide basis. *See id.* at 64-65. Only in its reply brief — which petitioners had no opportunity to answer — did Philip Morris cite *federal* authority specific to consent orders, such as *Mandel Brothers*, to support its contention that such orders establish federal "policy" binding on non-parties to the decree. Appellant's Reply Br. 34-35 & n.28 (Ill. filed Oct. 4, 2004).

Given that Philip Morris itself raised the federal issue of the effect to be given the FTC consent orders, there was nothing for petitioners to waive. In any event, the Illinois court properly considered and passed on the issue on which petitioners seek certiorari: "With regard to the 1971 and 1995 consent orders, plaintiffs dispute their relevance to the conduct of any industry actor other than the company that was a party to the enforcement action." Pet. App. 53a. Because the Illinois court "passed upon" that federal issue, it is well settled that this Court "permits review of [the] issue." *Lebron v. National R.R. Passenger Corp.*, 513 U.S. 374, 379 (1995) (internal quotation marks and alteration omitted); *see United States v. Williams*, 504 U.S. 36, 40-45 (1992).[5]

II. THIS PETITION RAISES IMPORTANT ISSUES WARRANTING THIS COURT'S REVIEW

Philip Morris has not disputed that the federal-law issues raised by the Illinois court's decision are important

---

[5] The additional authorities cited by petitioners on this point are only "new argument[s] to support what has been [a] consistent claim" that the FTC consent orders did not authorize Philip Morris's conduct. *Lebron*, 513 U.S. at 379.

and recurring. *See* Pet. 24-27. In fact, Philip Morris acknowledges (Opp. 17 n.14) that the issues are relevant to important suits pending across the nation in which it is defending against liability with the same arguments erroneously accepted by the court below. Its arguments against this Court's review are unpersuasive.

A. The Court Below Erred In Interpreting The Purpose And Effect Of FTC Consent Orders

Philip Morris's arguments either have been addressed in the petition or are otherwise irrelevant to whether consent orders serve as industry-wide rules.

First, Philip Morris claims that agencies "often set industry-wide policies through administrative adjudications and other informal means . . . including consent decrees." Opp. 18-19. It purports to support that proposition with decisions holding that agencies may set rules through *adjudication*. *See id.* But that distinctive form of agency decision-making says nothing about whether consent orders entered *in lieu of* adjudication may also establish industry-wide rules. They do not. *See* Pet. 23.[6]

Second, Philip Morris's assertion (Opp. 19) that the FTC is "particularly accustomed to setting policy" through consent orders is contradicted by longstanding FTC practice. *See* Pet. 18-20. Neither *Mandel Brothers* nor *Holloway* establishes that consent orders are vehicles for enacting industry-wide rules. *See* Pet. 18 n.9, 23.[7] And *Abrams* concerns only whether a *party* to a consent order may argue that the order preempts inconsistent state-law obligations. *See* 897 F.2d at 36, 39.

---

[6] Respondent's other case (Opp. 19), *San Francisco Police Officers' Ass'n v. City & County of San Francisco*, 812 F.2d 1125, 1129 (1987), *withdrawn and superseded*, 869 F.2d 1182 (9th Cir. 1988), holds only that a civil service rule that prevents a city from complying with a consent decree — to which it was a *party* — may be preempted.

[7] *O'Neill Investigations* and *Schubach v. Household Finance Corp.*, 376 N.E.2d 140 (Mass. 1978), which accord with the decision below, misconstrue *Mandel Brothers* and ignore *du Pont*. *See* Pet. 10-11, 18 n.9. They also conflict with the majority rule. *See* Pet. 11-14.

Philip Morris also points out (Opp. 19-20) that the FTC routinely subjects proposed consent orders to notice-and-comment procedures. But it presents no authority that giving affected persons an opportunity to comment on a consent decree transforms that decree into an industry-wide rule. In any event, Philip Morris's suggestion is contradicted by the FTC's longstanding practice and 15 U.S.C. § 45(m)(1)(B), both of which flatly reject Philip Morris's position. *See* Pet. 18-20.[8]

Third, Philip Morris argues (Opp. 20) that, "when an agency permits one member of an industry to engage in certain conduct . . . , the agency cannot prohibit similarly situated competitors from engaging in the same conduct." Notably, nothing in the Illinois court's decision suggests that as a rationale for its holding. And with good reason. That principle conflicts with this Court's decisions, federal courts of appeals' decisions, and the FTC's own exercise of prosecutorial discretion. *See* Pet. 11-14, 16-20; *infra* p. 9. Indeed, if Philip Morris were correct, the cases cited in the petition for the conflict would have come out differently, because they hold that an FTC consent decree does not bind a non-party to the decree. Such a decree therefore cannot *authorize* a non-party's conduct.[9]

Fourth, Philip Morris attempts to reconcile the Illinois court's holding with this Court's decisions. *See* Opp. 24-25. It argues, for example, that *du Pont* did not address whether FTC consent orders provide implied authorization to engage in conduct, but instead merely concluded

---

[8] Philip Morris cites (Opp. 20 n.16) a hodgepodge of other authority on consent decrees but makes no effort to differentiate the organic statutes underlying different agencies' practices. As the unrebutted authorities in the petition make clear, *FTC* consent orders do not establish agency policy. *See* Pet. 15-22.

[9] Philip Morris's assertion (Opp. 23 & n.20) that whether an FTC consent order can be enforced against a non-party is irrelevant ignores Congress's amendment to section 45(m)(1)(B), which demonstrates that Congress views FTC consent orders as a unique agency tool that cannot be used to set industry-wide policy. *See* Pet. 15-16.

that "the remedies that the FTC had provided for in previous consent decrees were not binding on the Court in determing what relief was appropriate." Opp. 24. But, by making clear that a non-party has no legal claim to a remedy afforded to other parties in consent orders, *du Pont* establishes that consent orders have no effect outside of the proceedings in which they are entered. *Du Pont*'s holding thus demonstrates the fundamental error of the Illinois court's judgment. *See* 366 U.S. at 330 n.12. That erroneous view of FTC consent decrees will disrupt the settled practices of the FTC, which will now have to gauge the effect on state law enforcement efforts as to non-parties every time it enters into a consent decree.[10]

B. The Divide Over The Legal Effect Of FTC Consent Orders Is Significant

Philip Morris agrees that the Eighth Circuit and the Alaska Supreme Court have sided with the Illinois court's view that FTC consent orders immunize non-parties from liability for similar conduct. Philip Morris wrongly disputes that the D.C., Seventh, and Federal Circuits, and the supreme courts of Florida and Massachusetts, conflict with those judgments.

Philip Morris argues (Opp. 21-22) that *Trans Union* is distinguishable because no third party there sought to claim a benefit from the FTC decree. But that case clearly holds that FTC orders neither bind nor authorize third-party conduct. The FTC denied to a regulated party the right to engage in certain conduct in which a prior consent order had allowed *another party* to engage. *See In re Trans Union Corp.*, 2000 FTC LEXIS 23, at *38 n.22. The FTC reasoned that the prior order had no "preceden-

---

[10] Philip Morris devotes pages to a recitation of its various lower court arguments and evidentiary positions that were either rejected or avoided below. Issues of class certification and damages have no bearing on the propriety of this Court's review: the majority "decline[d] to address" the certification issues, Pet. App. 85a, and, whatever the appropriate measure of damages, the court's error of federal law has prevented Illinois consumers from recovering *any* damages.

tial effect to [its] opinion." *Id.* Although the D.C. Circuit kept open the possibility that the FTC's action might be subject to an arbitrary-and-capricious challenge, it affirmed the FTC and adopted the FTC's reasoning that the consent order "[was] not before [the FTC] in this matter and it [was] without precedential effect on this opinion." 245 F.3d at 816-17 (internal quotation marks omitted).

Philip Morris's attempt (Opp. 22-23) to distinguish *Beatrice Foods* is nonsensical. It reads the decision to imply that a non-party to the decree can rely on it when the FTC "has not changed its . . . views." *Id.* But the Seventh Circuit's holding — that an industry participant could not rely on a prior consent decree entered against a different entity because it was not "controlling precedent" — cannot be reconciled with the decision below regardless of any change in the agency's views. *See* 540 F.2d at 312. In any event, the FTC disputes Philip Morris's use of "light" descriptors, both in a 1997 notice and in the United States' landmark RICO suit. *See* Pet. 21-22 & n.11. The conflict between the Seventh Circuit and the Illinois Supreme Court should be resolved to avoid disparate results between state and federal courts on the same principle of law.

Intergraph Corp., *Sakon*, and *Whitinsville Plaza* also conflict with the decision below for similar reasons. Those cases concerned not simply the enforcement of specific terms of a consent order against a non-party, but rather whether an FTC consent order establishes policy that can affect the rights, duties, or responsibilities of non-parties to the proceeding. *See* Pet. 11-14. In each case, the answer was "no" — an outcome in conflict with the Illinois court's holding that FTC consent orders "authorize" a non-party's conduct.[11]

---

[11] There is no merit to Philip Morris's suggestion (Opp. 23) that this Court must consider a conflict only as to the application of an FTC consent decree under other States' unfair practices statutes. Had the court below applied the majority rule and the FTC's own interpretation

III. THE COURT SHOULD ALSO CONSIDER HOLDING THIS CASE FOR *WATSON* OR CALLING FOR THE GOVERNMENT'S VIEWS

This Court has called for the Solicitor General's views in *Watson v. Philip Morris Cos.*, No. 05-1284 (filed Apr. 7, 2006). In offering the government's position on whether the FTC so heavily regulates Philip Morris that the company may invoke the federal officer removal provision, the Solicitor General will likely address the legal effect to be given the 1971 and 1995 FTC consent decrees, because the Eighth Circuit in *Watson* relied on those decrees to support its erroneous holding that they authorize or control Philip Morris's conduct. The Solicitor General's views could inform the Court in considering the issue raised here, which would counsel in favor of holding this petition for disposition of *Watson*. Alternatively, given the substantial federal interests implicated by the lower court's erroneous understanding of FTC consent decrees, *see* Pet. 24-27, if it does not grant certiorari outright in this case, the Court may wish to request the views of the United States in this case as well, so that the Solicitor General may take into account the consequences to the FTC of the Illinois Supreme Court's ruling below in formulating a position that would inform the proper disposition of both this case and *Watson*.

CONCLUSION

For the foregoing reasons and those stated in the petition, the petition for a writ of certiorari should be granted. Alternatively, the case should be held pending the disposition of *Watson v. Philip Morris*, No. 05-1284, or the views of the United States should be requested.

---

of the legal effect of the FTC consent decrees, the outcome below would have been different. That is sufficient to show a conflict.

Respectfully submitted,

STEPHEN M. TILLERY
701 Market Street
Suite 300
St. Louis, Missouri 63101
(314) 241-4844

DAVID C. FREDERICK
Counsel of Record
MARK L. EVANS
KELLY P. DUNBAR
KELLOGG, HUBER, HANSEN,
TODD, EVANS & FIGEL,
P.L.L.C.
1615 M Street, N.W.
Suite 400
Washington, D.C. 20036
(202) 326-7900

Counsel for Petitioners

October 25, 2006